Citizens Advice Scotland
Broadside, 2 Powderhall Road, Edinburgh EH7 4GB

Citizens Advice Scotland's response to the BEIS consultation on the Hydro Benefit Replacement Scheme and Common Tariff Obligation (September 2019)

Citizens Advice Network in Scotland

Citizens Advice Scotland (CAS), our 59 member Citizen Advice Bureaux (CAB) and the Extra Help Unit, form Scotland's largest independent advice network. Advice provided by our service is free, independent, confidential, impartial and available to everyone. Our self-help website Advice for Scotland provides information on rights and helps people solve their problems.

In 2017-18 the Citizens Advice Service network helped over 295,100 clients and dealt with almost 800,000 advice issues for clients living in Scotland. With support from the network clients had financial gains of almost £142.2 million and our self-help website Advice in Scotland received approximately 3.2 million page views. On energy consumers issues in particular, we advised on over 41,000 energy-related issues in 2017-18, generating over £1.8m in client financial gain[1].

Our extensive footprint is important in helping us understand how issues impact locally and nationally across the country and the different impacts that policies can have in different areas.

Who we are

The policy teams at CAS use research and evidence to put people at the heart of policy and regulation in the energy, post and water sectors in Scotland. We work with government, regulators and business to put consumers first, designing policy and practice around their needs and aspirations. We aim to represent the views of different consumer groups using evidence of consumer views and supporting research wherever possible.

CAS advocates for domestic and micro-business consumers on matters relating to energy networks in Scotland, and although we are separately funded organisations, we work closely with our colleagues at Citizens Advice in this area. We therefore welcome the opportunity to respond to BEIS' latest review of the Hydro Benefit Replacement Scheme (HBRS) and the

[1] https://www.cas.org.uk/system/files/publications/cas_energy_advice_detail_2017_18_published.pdf

Citizens Advice Scotland
Broadside, 2 Powderhall Road, Edinburgh EH7 4GB

Common Tariff Obligation (CTO). Our response to this consultation is not confidential and it may be published in full.

A summary of our response

- CAS believes that the policy objectives of the HBRS and the CTO remain valid, and we support their retention for the duration of the next 3-year review period. We are however concerned about the continued effectiveness of the HBRS in the delivery of its stated aims. Over the past 3 years consumers in the North of Scotland have faced electricity distribution network costs that are at least 17.89% more than consumers in any other region of GB. CAS therefore believes that a review of the assistance amount provided by the HBRS is necessary.

- CAS continues to be concerned by the regressive nature of the way in which the HBRS is funded. At present, the cost of the HBRS is socialised by applying a flat rate, per kilowatt hour levy on all GB electricity bill-payers which is then used by Scottish Hydro Electric Power Distribution (SHEPD) to subsidise the cost of distributing electricity to consumers in the North of Scotland. This funding mechanism takes no account of an individual consumer's ability to pay. CAS believes that moving HBRS funding to general taxation should be explored.

- There remains a lack of transparency as to whether the full benefits of the HBRS are passed on to North of Scotland electricity consumers via their electricity supplier in all cases. HBRS transparency could be significantly improved were electricity suppliers required to demonstrate that its full benefits are being passed on to consumers as a condition of their supply licence.

- In a volatile energy retail market, the quarterly collection of HBRS levy funding from licenced electricity suppliers exposes all GB electricity bill-payers to potential financial detriment in the event that a supplier exits the market without fully meeting its HBRS liabilities to the Electricity System Operator (ESO).

- CAS believes that the extension of the HBRS to Shetland is a positive development that will provide a more equitable funding arrangement for the Shetland cross-subsidy than is achieved by an exclusive levy on electricity consumers in the North of Scotland. We are disappointed, however, that the CTO continues to be misaligned with the HBRS for non-domestic electricity consumers: the HBRS provides a mechanism to subsidise electricity distribution costs for both domestic <u>and</u> non-domestic consumers in the North of

Scotland, but the CTO extends only to domestic electricity consumers. CAS believes that the current review of the CTO provides an opportunity to address this.

Our response in detail

1. *Do you agree that the policy objectives if the Hydro Benefit Replacement Scheme and Common Tariff Obligation – which are focussed on ensuring that consumers in the North of Scotland are not unreasonably disadvantaged by the price differential in electricity distribution costs – remain valid?*

CAS believes that the figures provided in Appendix B to the consultation document and reproduced in Table 1 below demonstrate that the policy objective of the HBRS remains valid as consumers in the North of Scotland continue to face significantly higher electricity distribution network charges than those resident elsewhere in Great Britain. On this basis, we support the retention of a subsidy mechanism designed to mitigate against this disparity as without this support, the full cost of distributing electricity to consumers in the North of Scotland would be borne by those same consumers. If this were the case it would mean almost £61 million per annum in additional charges to North of Scotland consumers, and this would have a material and detrimental impact on affordability and fuel poverty rates, which are typically already significantly higher than elsewhere in Scotland[2].

While it does not affect our support for such a subsidy, we would however argue that the provision of data relating to the electricity distribution network costs incurred by a GB average dual fuel consumer in each of the electricity distribution regions serves as a poor comparator for those in the North of Scotland, where 59.5% of properties are not connected to mains gas[3] and total electricity consumption is typically above the GB average[4]. Electricity distribution network costs in each of the distribution regions for a more representative Profile Class 2 electricity consumer to that typically found in the North of Scotland would therefore arguably provide a more representative comparator against which to assess the ongoing need for, and the effectiveness of, the HBRS. We would expect that those figures would make the case for ongoing subsidy even more compelling.

[2]Key results from the Scottish House Condition Survey (SHCS) Local Authority tables 2015-2017
[3]https://www.cas.org.uk/system/files/publications/2018-08-15_off-gas_report_final_0.pdf
[4]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/789581/Postcode-level-E7-electric-2017.csv

Citizens Advice Scotland
Broadside, 2 Powderhall Road, Edinburgh EH7 4GB

Table 1: Regional estimates of typical GB customer cost (£ Real (2017-18 price base) per typical domestic customer)[5]

Region	April 2014	April 2015	April 2016	April 2017	April 2018	April 2019
North West	101	94	96	79	78	82
North East	104	103	101	91	85	88
Yorkshire	87	89	83	76	73	73
Midlands	81	84	96	83	80	78
East Midlands	76	80	86	76	71	71
South Wales	117	102	116	102	98	99
South West	118	113	126	113	100	97
London	80	70	79	67	65	71
South East	96	91	107	91	81	87
East Anglia	79	81	82	79	76	78
South Scotland	89	102	99	91	91	92
Merseyside & N Wales	136	128	112	104	99	110
North Scotland	140	130	142	125	123	121
Southern	85	85	90	81	74	71
Weighted GB average	94	96	101	90	85	87

The HBRS is complemented by the CTO, which prevents licenced domestic electricity suppliers from offering less favourable terms to their electricity customers in more rural parts of the North of Scotland as compared to those in more heavily populated areas of the same distribution region. This avoids differential pricing according to geographical location. As a result, the CTO provides an important barrier to the implementation of a rurality or island premium in domestic electricity pricing in the North of Scotland and helps to ensure that domestic consumers in the North of Scotland electricity distribution area are treated equally. While this may result in an inflationary effect on prices in more densely populated areas of that region, the overall effect of the CTO ensures that the North of Scotland electricity distribution area functions in a consistent manner to the other 13 electricity distribution areas in GB. On this basis, we therefore support the continuation of the CTO.

However, we also believe that the current review of the CTO presents an opportunity to extend the protections it provides to non-domestic consumers in the North of Scotland such

[5] https://www.ofgem.gov.uk/publications-and-updates/riio-electricity-distribution-annual-report-2017-18

Citizens Advice Scotland
info@cas.org.uk
www.cas.org.uk
Patron: The Princess Royal

that it is fully aligned with the HBRS by supporting both non-domestic and domestic consumers. This would remove a barrier to cost competitiveness for businesses in remote rural and island communities in the North of Scotland. In turn this could help to boost employment rates and economic vibrancy in such communities, and we would expect that this would have a positive trickle-down effect on fuel poverty rates in these areas.

2. *Do you agree that the Hydro benefit Replacement Scheme and Common Tariff Obligation remain operationally effective and should be retained?*

Page 8 of the consultation document highlights a 13.57% reduction to overall electricity distribution network costs to consumers in the North of Scotland since 2014. In absolute terms, the figures provided in Appendix B to the consultation document and reproduced in Table 1 above show that this reduction is almost twice the weighted national average across the 14 electricity distribution network operators (DNOs) over the past 6 years, ranking SHEPD as the second best performing DNO on this metric. Despite this, however, whilst consumers in the North of Scotland saw comparable electricity distribution network costs to those in Merseyside and North Wales in both 2014 and 2015, electricity consumers in the North of Scotland have faced distribution network costs that are significantly higher than those incurred in any other region in Great Britain in each of the past 4 years. CAS is therefore concerned that the effectiveness of the HBRS has been diluted in recent years to the extent that it no longer achieves its fundamental objective of ensuring that electricity distribution network charges in the North of Scotland are not markedly higher than the next highest charging regions.

The figures presented in Table 1 above show that a dual fuel consumer in the North of Scotland who uses 3,100kWh of electricity per annum will have paid £166 more in electricity distribution network costs over the past 3 years than those in the cheapest electricity distribution network area (London) – where average network costs during that time have been just £67.67 per annum – and £56 more in electricity distribution network costs than those in the second most expensive region of Merseyside and North Wales. A GB average dual fuel consumer in the North of Scotland will therefore have paid 17.89% more in electricity distribution network costs than a similar consumer in any other region of Great Britain (and 81.77% more than those in London) since the assistance amount provided by the HBRS was last reviewed. The current review of the HBRS must therefore seek to understand and address this imbalance in the context of the proposed changes to the funding of the Shetland cross-subsidy and any potential future cost pressures arising from OFGEM's ongoing work on the Targeted Charging Review (TCR).

CAS is also concerned about the regressive nature of the way in which the HBRS is funded. In our response to the 2016 review of the HBRS and the CTO, we observed that the imposition of a per kilowatt hour levy on the electricity used by domestic and non-domestic consumers throughout Great Britain applies this charge irrespective of any given consumer's ability to pay[6]. While the overall cost to the average domestic dual fuel consumer's electricity bills arising from this levy is said to have averaged less than £1 per annum over each of the past 3 years, official figures show that consumers reliant on electricity as a source of space heating and hot water typically require to use more electricity than an equivalent dual fuel household[7], with typical electricity consumption in off-gas areas of the North of Scotland particularly high[4]. Our research has also shown that those consumers whose properties are not connected to mains gas are considerably more likely to be in fuel poverty than those who are able to make use of alternative fuel sources for such purposes, with electrically-heated homes most likely of all to be fuel poor in Scotland[2].

The cost of the HBRS to those reliant on electricity for space heating and hot water is therefore likely to be significantly higher than the GB average dual fuel figures quoted in the consultation document, and its current funding mechanism results in a situation whereby many fuel poor consumers in Scotland are asked to fund a disproportionately large amount towards the total HBRS levy simply because they have no access to an alternative source of fuel for space heating and hot water. Similar concerns also exist in relation to high consumption, income poor dual fuel households, many of whom would be considered vulnerable by OFGEM.

In the context of a wider system of environmental and social levies that contributes 20.44% to the total of a typical GB electricity bill[8], the current design of the HBRS funding mechanism can therefore be said to be regressive as those least able to pay are often asked to contribute most towards the total levy funding. This is counter to the aims of the Welsh Assembly and the governments of both Scotland and the United Kingdom to alleviate fuel poverty. CAS therefore continues to believe that removing the HBRS and other levies from consumers' bills and funding such assistance via general taxation instead is a more socially just mechanism by which to fund such levies.

---

[6] https://www.cas.org.uk/system/files/publications/casresponsetoconsultationonthehbrsandcto.pdf
[7] https://www.ofgem.gov.uk/gas/retail-market/monitoring-data-and-statistics/typical-domestic-consumption-values
[8] https://www.ofgem.gov.uk/consumers/household-gas-and-electricity-guide/understand-your-gas-and-electricity-bills

Citizens Advice Scotland
Broadside, 2 Powderhall Road, Edinburgh EH7 4GB

Shifting HBRS levy funding liability from bill-payers to taxpayers would also protect against the potential for further consumer detriment arising from recent volatility in the retail energy market that has already seen 21 licenced electricity suppliers and white labels exiting the market since the beginning of 2018 due to market interventions and commercial pressures. Several of these suppliers are known to have been unable to meet their commitments in respect of the payment of obligated environmental and social levies at the time of their exit from the market, and this has resulted in shortfalls that required to be met by the remaining suppliers trading in the retail energy market[9] – a cost which is likely to have been passed on to consumers.

Alternatively, the current review of the HBRS provides an opportunity for a cost-benefit analysis to be undertaken on the relative merit of requiring the ESO to collect HBRS levy funding from licenced electricity suppliers on a monthly rather than quarterly basis. This would help to mitigate against any potential HBRS shortfall arising from any future electricity supplier failure, though would not completely remove this risk.

Finally, we note that on Page 9 of the consultation document it is stated that the HBRS "was established on the basis that the competitive market for electricity supply in the North of Scotland would be sufficient to ensure that the assistance provided by the scheme would feed through to consumers". As noted above, however, the majority of consumers in the North of Scotland electricity distribution network area are not connected to mains gas, and electric heating is therefore commonplace[3]. The majority of such consumers are also known to have been provided with a type of 'restricted' multi-rate electricity meter that, until September 2017, very few suppliers were able to support[10]. Competition for these consumers has therefore until recently been virtually non-existent, and this was one of the reasons why the CMA introduced the Restricted Meter Remedy following its Energy Market Investigation[11].

In January 2019, however, CAS published research which revealed that despite the introduction of the Restricted Meter Remedy in September 2017, switching rates in the North of Scotland remain significantly lower than elsewhere[12]. With the effectiveness of the Restricted Meter Remedy for all restricted meter types yet to be thoroughly assessed, there

[9] https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/SoLR%20report%20FINAL_v2.pdf
[10] https://www.ofgem.gov.uk/sites/default/files/docs/2013/07/the-state-of-the-market-for-customers-with-dynamically-teleswitched-meters_0.pdf
[11] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/584895/energy-market-restricted-meters-order-2016.pdf
[12] https://www.cas.org.uk/news/new-data-shows-huge-differences-across-scotland-energy-switching-rates

is therefore a risk that the prevailing market conditions in the North of Scotland are not yet sufficiently robust to guarantee that the benefits of the HBRS are passed on to consumers in full in all cases. CAS therefore continues to believe that confidence in the consumer benefits of the HBRS could be better ensured if a new Licence Condition were introduced. This would place a statutory requirement upon all licenced domestic and non-domestic electricity suppliers to evidence in a clear and transparent manner that the discount to SHEPD's distribution costs has been applied in full to the prices they charge consumers in the North of Scotland.

3. *Do you agree that the Hydro Benefit Replacement Scheme is the most appropriate way to deliver revised funding arrangements for the Shetland cross-subsidy? If not, why not, and what other mechanism(s) should be considered?*

In our response to the 2016 review of the HBRS and the CTO[4], CAS supported the proposed revision of the funding arrangements for the Shetland cross-subsidy in principal, though sufficient detail on the funding of the Shetland New Energy Solution was not available at the time to enable us to adopt a final position on these proposals. Since then, OFGEM and Scottish Hydro Electric Transmission Limited (SHETL) have agreed to defer the proposed alternative energy solution for Shetland, and a life extension program of the existing asset base has been agreed with SHEPD as an interim measure. Given the relatively short expected lifespan of the interim measure, however, it has not been deemed appropriate to capitalise the costs associated with the interim measure using traditional models. Agreement has therefore been reached between OFGEM and SHEPD to fund the interim measure over a shorter period of time than would normally be the case.

This avoids a scenario where future consumers would be asked to fund the cost of both the life extension program and the alternative energy solution. While this approach protects the interests of future consumers, it necessarily increases the costs to those currently connected to the distribution network. CAS therefore supports the use of the revised funding arrangements for the Shetland cross-subsidy in the financing of the interim measure given the relatively short period of time over which those infrastructure costs are to be funded.

4. *Do you agree that the proposed design of the revised funding arrangements for the Shetland cross-subsidy is likely to be effective? If not, what changes or additions should be made?*

The proposed design of the revised funding arrangements for the Shetland cross-subsidy will ultimately only be as effective as OFGEM's estimates are accurate for SHEPD's expenditure in the final 3 years of RIIO-ED1. Looking further ahead, however, it will be important to review the assistance amount provided for the Shetland cross-subsidy ahead of RIIO-ED2 in the context of SHETL's final business plan for RIIO-T2 and the outcome of the 2019 Contracts for Difference (CfD) auctions in September 2019.

5. *Does the proposed design of the revised funding arrangements for the Shetland cross-subsidy achieve predictability of charges, transparency, and efficiency of operation? Are there other important aspects that should be taken into account?*

The proposed design of the revised funding arrangements for the Shetland cross-subsidy are likely to be operationally efficient as they utilise an existing mechanism that is well understood and cost effective to administer. The overlap between the forthcoming HBRS review period and RIIO-ED1, both of which are set to run until 31 March 2023, should also provide for predictability of charges during this time. As stated above, however, it will be important that the assistance amount provided for the Shetland cross-subsidy is properly reviewed ahead of RIIO-ED2.

CAS believes that the transparency of the revised funding arrangements proposed will be aided by the proposal to define the assistance amount to be provided for the Shetland cross-subsidy independently of the subsidy reserved for the rest of the North of Scotland in the proposed Regulations. We also believe, however, that transparency could be further enhanced by the provision of a Licence Condition that would place a statutory requirement upon all licenced domestic and non-domestic electricity suppliers to evidence in a clear and transparent manner that the discount to SHEPD's distribution costs afforded by the Shetland cross-subsidy has been applied in full to the prices charged to consumers in Shetland.